

Internal Revenue Service

memorandum

date: May 7, 2003

to: Director, Exempt Organizations Examinations T:EO:E
Director, Rulings and Agreements T:EO:RA

from: (signed) Director, Exempt Organizations T:EO

subject: Examinations and Determinations During IRC 501(m) Guidance Project

The purpose of this memorandum is to provide directives for handling examination and exemption application cases involving health maintenance organizations and IRC 501(m) as a result of Notice 2003-31, 2003-21 I.R.B. ____ (5/27/03).

Notice 2003-31 announced that the Treasury Department and the IRS intend to propose regulations providing guidance under IRC 501(m), which will define the term “commercial-type insurance” and address how IRC 501(m) applies to organizations described in IRC 501(c)(3) and (4). In addition, this Notice announced the withdrawal from the Internal Revenue Manual of the examination guidelines in Handbook 7.8.1, Chapter 27, which relate to the application of IRC 501(m) to health maintenance organizations.

The following directives will apply for a period of eighteen months from the date of this memorandum. At the end of this eighteen-month period, we will reevaluate these directives, taking into consideration the status of the regulation project and pending examination and exemption application cases.

Examinations

In general, we will not apply IRC 501(m) to revoke the tax-exempt status of a health maintenance organization. Therefore, you may not propose revocation of exemption of an IRC 501(c)(3) or 501(c)(4) health maintenance organization based on IRC 501(m), unless you have requested and received approval for such action from the Director, Exempt Organizations Examinations and the Director, Rulings and Agreements.

Whether unrelated business income tax under IRC 511 should apply to a health maintenance organization, based on its providing “commercial-type insurance” under IRC 501(m), should be considered on a case-by-case basis. To ensure consistency, you should consult with the members of the 501(m) coordinating group named at the end of this memorandum.

If a health maintenance organization no longer meets the requirements for exemption under IRC 501(c)(3), without considering IRC 501(m), exemption may be revoked. However, if an organization consents to revocation of its IRC 501(c)(3) status, it may request recognition of exemption under IRC 501(c)(4), by filing Form 1024, *Application for Recognition of Exemption*

Examinations and Determinations During IRC 501(m) Guidance Project

Under Section 501(a), along with a user fee as provided in Form 8718, *User Fee for Exempt Organization Determination Letter Request*. EO Determinations should forward any such application to EO Technical, which will process the application without considering IRC 501(m). EO Examinations and EO Technical will coordinate the revocation and exemption process through the members of the 501(m) coordinating group.

If a health maintenance organization no longer meets the requirements for exemption under IRC 501(c)(4), without considering IRC 501(m), exemption may be revoked.

Determinations

EO Determinations shall refer all applications from health maintenance organizations for recognition of exemption under IRC 501(c)(3) or 501(c)(4) to EO Technical. EO Technical will suspend consideration of any IRC 501(c)(4) exemption application filed by a health maintenance organization. As previously noted, an exception will be made for an application filed by an organization that consents to revocation of its IRC 501(c)(3) status and requests recognition of exemption under IRC 501(c)(4). EO Technical will process any IRC 501(c)(3) exemption application filed by a health maintenance organization whose activities are directed to arranging the provision of health care services exclusively for Medicaid (or similar) beneficiaries, without considering IRC 501(m).

Non-HMO Cases

EO Determinations and EO Examinations should consult with the members of the 501(m) coordinating group about examination and exemption application cases involving the potential application of IRC 501(m) to organizations other than health maintenance organizations.

Coordinating Group

The 501(m) coordinating group is comprised of representatives from EO Technical, EO Examinations and TE/GE Counsel. The contact person for the 501(m) coordinating group is Larry Brauer (202) 283-9457, and in his absence, Marv Friedlander (202) 283-9461.